DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS: 03-0378
Indiana Individual Income Tax
For 1999 Tax Year

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ISSUE

I. **Gambling Losses** – Individual Adjusted Gross Income Tax.

Authority: Ind. Const. art. 10, § 8; IC 6-2.1-1-2(a); IC 6-2.1-2-2; IC 6-3-1-1 et seq.; IC 6-3-1-3.5; 45 IAC 3.1-1-1; I.R.C. § 61; I.R.C. § 62; I.R.C. § 165; I.R.C. § 165(d); 2002 U.S. Master Tax Guide (CCH 2002); Black's Law Dictionary (7th ed. 1999).

Taxpayer challenges an assessment of additional adjusted gross income tax on the ground that the additional taxes are based upon gambling earnings and that taxpayer should be permitted to offset the gambling losses against these particular earnings.

STATEMENT OF FACTS

Taxpayer received a notice of "Proposed Assessment" indicating that taxpayer owed an amount of additional Indiana income tax for 1999. This proposed assessment was apparently issued after the Internal Revenue Service notified the Department of Revenue (Department) that taxpayer had previously been billed for additional federal income tax based upon unreported 1999 income. Taxpayer challenged the assessment of the additional Indiana taxes, a hearing was conducted during which taxpayer's representatives explained the basis for the protest, and this Letter of Findings results.

DISCUSSION

I. **Gambling Losses** – Individual Adjusted Gross Income Tax.

Taxpayer argues that in reporting his gambling earnings, he is entitled to offset his gambling losses against his gambling earnings. According to taxpayer, if he won $5,000 gambling but lost $4,000, taxpayer should only be required to pay taxes on $1,000 in winnings. However, taxpayer contends that he should be permitted to offset gambling losses only to the extent that his gambling earnings exceed the losses. Thus, if taxpayer won $2,000 but lost $3,000, he would be entitled to offset the entire $2,000 in earnings; taxpayer pays taxes on $0 in gambling income.

Taxpayer's argument is based on the contention that, "The Gross Income Tax imposed by the State of Indiana is unconstitutional under Article 10, Section 8 of the Indiana Constitution." That constitutional provision permits the Indiana General Assembly to "levy and collect a tax upon income from whatever source derived, at such rates, in such manner, and with such exemptions as may be prescribed by law." Ind. Const. art. 10, § 8. Specifically, taxpayer challenges IC 6-2.1-1-2(a) which states that, "Except as expressly provided in this article, 'gross income' means all the gross receipts a taxpayer receives . . . ." Taxpayer takes this to mean that gambling winnings are not "income" to the extent that the winnings are offset by gambling losses. As taxpayer summarizes, "The Indiana Gross Income tax, to the extent that it taxes beyond income is unconstitutional under the Indiana Constitution and contrary to Indiana case law, and therefore [taxpayer] should be allowed to deduct his losses to the extent of his winnings."

Taxpayer believes that the proposed assessment is incorrect because the state legislature exceeded its constitutional mandate in imposing a gross income tax on "gross receipts," that the Indiana Constitution allows only a tax on "income," and that gambling losses are inherently not part of a taxpayer's "income." (e.g. $800 in gambling earnings + $200 in gambling losses = $600 in taxable income.)

Metaphorically speaking, taxpayer is barking up the wrong tree. It is not necessary to determine if gambling losses should be excluded from "gross receipts" because taxpayer was not assessed gross income tax. Indiana's gross income tax is imposed exclusively on corporate entities which are either residents or domiciliarys of Indiana or on non-resident business entities which nonetheless derive income from doing business within the state. IC 6-2.1-2-2. The proposed assessment was issued pursuant to the provisions of the individual adjusted gross income tax provisions set out in IC 6-3-1-1 et seq.

IC 6-3-1-3.5 states as follows: "When used in IC 6-3, the term 'adjusted gross income' shall mean the following: (a) In the case of all individuals 'adjusted gross income' (as defined in Section 62 of the Internal Revenue Code) . . . ." Thereafter, the statute specifies addbacks and deductions, peculiar to Indiana, which modify the Federal adjusted gross income amount. The Department's regulation concisely restates the formulary principal. 45 IAC 3.1-1-1 defines individual adjusted gross income as follows:

> Adjusted Gross Income for Individuals Defined. For individuals, "Adjusted Gross Income" is "Adjusted Gross Income as defined in Internal Revenue Code § 62 modified as follows:
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> > (1) Begin with gross income as defined in section 61 of the Internal Revenue Code.
> > (2) Subtract any deductions allowed by section 62 of the Internal Revenue Code.
> > (3) Make all modifications required by IC 6-3-1-3.5(a).

Both the statute, IC 6-3-1-3.5, and the accompanying regulation, 45 IAC 3.1-1-1, require that an Indiana taxpayer employ the Federal adjusted gross income calculation, as determined under I.R.C. § 62, as the starting point for determining the taxpayer's Indiana adjusted gross income.

I.R.C. § 62 states that, "For purposes of this subtitle, the term 'adjusted gross income' means, in the case of an individual, gross income minus the following deductions . . . ." The deductions specified under I.R.C. § 62 contain no provision permitting an individual to deduct gambling losses from his gross income. However, the federal law does permit the deduction of gambling losses to the extent of the taxpayer's gains from similar transactions. I.R.C. § 165(d). "Nonbusiness gambling losses are deductible only as deductions itemized on schedule A of Form 1040." 2002 U.S. Master Tax Guide para. 788, p. 248 (CCH 2002). Thereafter, the total amount of itemized deductions from Schedule A is then subtracted from the amount of federal adjusted gross income yielding federal "taxable income."

Nevertheless, I.R.C. § 165 does not get taxpayer where he wants to go. Although Indiana's income tax piggybacks on the federal tax, it piggybacks on federal "adjusted gross income" and not on "taxable income." The deduction permitted by I.R.C. § 165(d) is a "below the line adjustment" – taken after determining adjusted gross income – and is irrelevant in determining the amount of Indiana income tax.

"Gross income" is "[t]otal income from all sources before deductions, exemptions, or other tax reductions." Black's Law Dictionary p. 766 (7th ed. 1999). I.R.C. § 61 defines "gross income" as "all income from whatever source derived" Gambling winnings are merely one portion of any taxpayer's "income from all sources." The specific deductions listed under I.R.C. § 62 are then subtracted from the amount of "gross income" to yield a number called "adjusted gross income." It is that particular number which is the jumping off point for determining Indiana adjusted gross income. Under IC 6-3-1-3.5, Indiana permits a number of additional, state-specific modifications but, as in I.R.C. § 62, there is nothing in IC 6-3-1-3.5 which permits an Indiana taxpayer to deduct an amount for gambling losses.

Under Ind. Const. art. 10, § 8, the state legislature has seen fit to adopt a taxing scheme which taxes gambling earnings as one part of a taxpayer's adjusted gross income. It has also decided that there is no deduction, exemption, or exclusion for associated gambling losses. Therefore, the Department does not accept taxpayer's assertion that the state's income tax scheme is unconstitutional. For whatever reasons, the state legislature has determined that Indiana residents may not deduct gambling losses from that citizen's adjusted gross income. There is nothing to indicate that the legislature exceeded its constitutional authority in making that determination. The Department must decline the opportunity to unilaterally carve out an adjusted gross income modification where none exists.

FINDING

Taxpayer's protest is respectfully denied.

DK/JM/MR – 030611